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BEFORE THE HOUSE AGRICULTURE SUBCOMMITTEE ON
GENERAL FARM COMMODITIES AND RISK MANAGEMENT

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Mr. Chairman and Members of the Subcommittee, thank you for the opportunity to join Risk Management Agency (RMA) Administrator Eldon Gould today to report on the status of the Federal crop insurance program. My comments are from the perspective of the Board of Directors (Board) of the Federal Crop Insurance Corporation (FCIC), which I chair. The Board has general management responsibility for the FCIC.

I will begin by acknowledging the outstanding efforts and accomplishments of the members of the FCIC Board. In addition to myself, current voting Board members include Mark Keenum, Under Secretary for Farm and Foreign Agricultural Services; Bill Classen; a resident of Iowa with expertise in the insurance industry; Frank Jones, a cotton and cattle producer from Texas; Tim Kelleher, a rice producer from California; Luis Monterde, a blueberry producer from Mississippi; Mike Pickens, an attorney from Arkansas with expertise in insurance regulation, and Curt Sindergard, a corn and soybean producer from Iowa. RMA Administrator Gould is Manager of the FCIC and a nonvoting member of the Board. The Board also greatly benefits from the assistance of Floyd Gaibler, Deputy Under Secretary for Farm and Foreign Agricultural Services, and Brent Doane, Secretary to the Board.

Crop Insurance Today

Crop insurance began in 1938 as a pilot program covering wheat. In 1939, there were about 7 million acres enrolled in the pilot crop insurance program. Over the next 40 years, crop insurance was primarily delivered to producers by Department of Agriculture employees through a program that grew slowly and was limited in the number of crops covered. By 1979, crop insurance was available in only about half of the nation's counties. Reliance on disaster assistance and concerns about adverse effects of crop insurance, such as moral hazard and bringing higher risk land into production, led to landmark crop insurance reform legislation in 1980. The Federal Crop Insurance Improvement Act 1980 made crop insurance delivered through the private sector the primary form of disaster assistance for producers. Subsequent legislation, the Federal Crop Insurance Reform Act of 1994 and the Agricultural Risk Protection Act of 2000 (ARPA), continued program improvements, increased premium subsidies and expanded program offerings and participation.

The performance of crop insurance under ARPA may be illustrated by comparing program data for the 2006 crop year, the most complete recent year of data, with data for 1998, the year prior to the increase in premium subsidies that began first with ad hoc disaster legislation for 1999 and 2000 and then legislated through ARPA for subsequent years (table). In 2006, there were 1.15 million Federal crop insurance policies earning premiums, slightly below the 1.24 million policies earning premiums in 1998. However, by 2006, insured liability increased to about $50 billion, nearly 80 percent higher than the $28 billion liability in 1998. Insured acres increased to 242 million in 2006, up from 182 million in 1998. Total premiums increased to $4.6 billion in 2006, up over 140 percent since 1998. The sharp increases in these indicators reflect higher participation and coverage levels caused by higher premium subsidies, a pronounced shift from yield-only coverage to revenue coverage, and higher commodity prices, which have increased revenue insurance guarantees.

Since the increase in premium subsidies under ARPA and the disaster legislation in the late 1990s, more farmers are buying coverage above the catastrophic risk protection (CAT) level. In 1998, CAT coverage accounted for 34 percent of the program's insured acreage. In 2006, only 12 percent of insured acres were covered at the CAT level. For most producers, buying policies with increased buy-up coverage is necessary to manage risks more effectively and to allow them to move away from dependence on Government ad hoc disaster assistance.

While we have seen growth in insured liability for the major row crops over the past decade, we have also seen an increase in coverage for many specialty crops. Broader specialty crop coverage has resulted from pilot programs initiated in the late 1990s, programs authorized in ARPA, and the expansion of Adjusted Gross Revenue (AGR) and AGR-Lite plans of insurance. The range of new products is illustrated by Board actions the April 2007 meeting, where a new plan of insurance for honey was approved for expert review, a plan for processing pumpkins was approved, and a pilot program for cultivated clams was modified and extended.

Insurance products that offer whole farm or revenue protection have grown sharply. For example, liability insured under the Revenue Assurance, Income Protection, and Crop Revenue Coverage plans of insurance increased from $4.8 billion, or 17 percent of total program liability, in 1998 to $23.5 billion, or 47 percent of total liability, in 2006. The whole farm plans of insurance Adjusted Gross Revenue (AGR) and AGR-Lite have risen from no liability to $351 million over the same period.

The popularity of area plans of insurance have also increased very sharply in recent years. Insured liability under the Group Risk Plan (GRP) and Group Risk Income Protection (GRIP) plans of insurance increased from $0.5 billion in 1998 to $6.8 billion in 2006—more than a 12-fold increase.

The actuarial performance of Federal crop insurance has steadily improved over the years. In the l981-1990 crop years, the loss ratio, which is total indemnities divided by total premiums, averaged 1.53. The loss ratio for 1991-2000 declined to an average of 1.07. And for 2001-2006, the loss ratio has averaged an even lower 0.91. Over time, premium rates have increased to cover expected losses. Part of the increase in premium rates was due to the assessment of historical experience and establishment of, and movement towards, target rates by RMA to cover expected losses. The increase in premium subsidies under ARPA also increased participation, drawing more low risk producers into the program, thereby reducing adverse selection and improving actuarial performance.

Federal crop insurance is delivered to producers entirely by private insurance companies. Over time, some companies have exited the business, others have merged or been acquired, and new entrants have joined the program. The Board and RMA serve as regulators of this private sector delivery structure, which must be efficient and financially healthy if the Federal crop insurance program is to succeed. Today, RMA has a Standard Reinsurance Agreement (SRA) with the 16 companies that constitute the public-private partnership for the delivery of Federal crop insurance. The SRA defines the risk sharing agreement between the government and the companies that is crucial to the efficient operation of the program. By being able to share in the underwriting gains, companies have an incentive to participate in the program and expand sales, and by sharing in the losses, they have an incentive to ensure policies are properly underwritten and loss adjusted.

The SRA also establishes the reimbursement to the companies for administrative and operating (A&O) expenses in accordance with the provisions of the Federal Crop Insurance Act (Act). For the 2006 reinsurance year, the rate at which we reimburse the companies' A&O costs has changed compared with earlier years. In 2000, the average reimbursement rate was 25.7 percent of net premium. In 2005, the average was 21.8 percent of net premium, and for the 2006-crop year, the average reimbursement is 20.7 percent.

For the 2006 insurance year, A&O reimbursements are estimated at $958 million, up from $443 million in 1998. Despite the decline in the A&O reimbursement percentage, the total dollar reimbursement is up because of the increase in premium per policy, primarily due to higher average coverage levels, greater purchase of revenue insurance, and RMA rate adjustments. Premium per policy has increased from $1,510 in 1998 to $3,989 in 2006. Underwriting gains for the companies are up as well, rising from $280 million in 1998 to $890 million estimated for 2006. The total delivery cost, A&O plus underwriting gains, have increased from about $0.72 billion in 1998 to $1.85 billion in 2006. The combined increases in A&O and underwriting gains have helped improve the financial performance of the companies since 2002, when the largest company became insolvent. The improved financial picture has also encouraged new entrants into the program.

Board Activities and Priorities

Management of the FCIC is vested in its Board of Directors, subject to the general supervision of the Secretary of Agriculture. Board members take actions necessary to protect the interests of producers, improve the actuarial soundness of the program, and apply program provisions to all companies and insured producers in a fair and consistent manner.

In the mid 1990s, when companies introduced new products, such as revenue products, they shouldered the research and development costs, and their products were immediately adopted by their competitors without compensation. ARPA provided that private entities may be reimbursed for research and development and maintenance costs for four years, if the product is submitted under section 508(h) of the Act (508(h) products) and approved by the Board for use in the Federal crop insurance program. Including our most recent meeting in April 2007, seventy 508(h) products have been submitted to the Board since mid 2000 when ARPA was enacted. Of that total, 42 have been approved by the Board, 6 have been disapproved or a notice of intent to disapprove has been issued, 13 were withdrawn by the submitter, three were returned or deemed incomplete or illegal, and 6 are in review. Approved 508(h) products range from a Livestock Risk Protection program for lambs to AGR-Lite.

The Board carries out its business through public meetings held 8-10 times per year and other working sessions among its members and has executed a detailed division of responsibilities between itself and RMA. With respect to those functions delegated to RMA, the Board regularly reviews RMA's performance. The Board also establishes the priority for RMA efforts to improve the operation of Federal crop insurance.

A continuing priority of the Board has been to work with RMA to deal with a large backlog of pilot programs. Because pilot programs are new programs, they must be continually monitored to ensure acceptable performance, and if they are not, immediate corrections must be made. Pilots generally are designed for 3 years and then must be evaluated. Based on the evaluation, the Board determines whether each pilot is then modified and continued, approved for permanent programs, or terminated. Many of these programs were initiated in the late 1990s to address perceived areas of insufficient insurance coverage, or they were authorized by ARPA. RMA currently administers 28 pilot programs for the 2007 crop year. Of the pilots initiated in the late 1990s or under ARPA, the Board has voted to terminate 7 programs, three were terminated and replaced by other pilots, 6 have been extended to gain more experience, 13 have been approved for conversion to permanent status, and 5 pilot programs are slated for evaluation during 2007-2008.

Generally, the process of going from an idea to a permanent program takes many years for an FCIC-originated product. As a result of the limitations on RMA to conduct research and development contained in the Act, the process includes a contracted feasibility study, a contracted policy development study, 3 or more years of piloting the program, a contracted evaluation study, and conversion to a permanent policy through notice and comment rulemaking.

In deciding the fate of a pilot program, as for any decision the Board makes, the Board considers whether its actions are in the interests of producers and the crop insurance program, whether such action can be implemented in an actuarially sound manner, and whether program integrity will be protected. An example of the difficulty of establishing an effective pilot program is the Florida Fruit Tree

Program. The Board voted to implement numerous program improvements for 2006 for the then-existing pilot program, which was not working well for Florida citrus producers. The changes included an occurrence loss option and an option for comprehensive tree value, which covers the lost asset value of destroyed trees. While the policy also provided coverage for losses due to Asiatic Citrus Canker (ACC), indemnification was predicated on an eradication order and the destruction of the trees by the State, which was required if ACC was discovered.

However, following 2005's hurricanes, the spreading of ACC changed the assessment of expected losses on which the premium rate structure of the policy was calculated. In addition, the State' policy of requiring the destruction of the trees changed, and we found it necessary to modify the policy again. The Board met with ACC experts, and RMA worked closely with other USDA agencies to monitor the changing approach to controlling ACC in the state of Florida. Because of the difficulty in rating the plan of insurance and the vulnerability that placed on the FCIC, as well as the likelihood that an unacceptable administrative burden would be placed on the companies, the Board voted to remove ACC coverage for the 2008 and succeeding crop years in the Florida Fruit Tree Pilot Insurance Program.

Another issue of concern to the Board is implementation and maintenance cost for insurance products that do not sell well and thus offer limited benefits to the producer. The Board has requested additional information on potential sales and costs from submitters before considering a product for approval and from RMA before taking action on pilot program evaluation. The Board considers whether the product could be better structured to meet the needs of producers and improve marketability and looks closely at the program's research and development costs, maintenance costs, and administrative complexity. High costs to USDA and the companies, which include information technology costs, agent training costs, sales barriers such as product complexity, and loss adjustment costs relative to policies sold, have been factors in the Board's determination of whether approval is in the best interest of producers. When rejecting a product or terminating a pilot program, the Board also considers the availability of alternative risk management tools for producers, including products such as AGR and AGR-Lite, which cover all of the farm's income from production.

During the past year, an evaluation report was completed on AGR that identified a number of potential changes that improve its effectiveness and marketability. The Board would like to continue to improve AGR and AGR-Lite so these products may serve the large number of crop-specific programs that generate low levels of sales. RMA is now assessing how the evaluation report recommendations, as well as recommendations from the companies, may be implemented to improve product performance. The Board has already reduced the number of commodities required to be produced in order to be eligible for higher coverage levels and discontinued the 75 percent coverage level/65 percent payment rate option for these whole-farm revenue policies. In addition a study has been completed on the premium rating of these policies which appear high in some cases, and we expect to implement adjusted rates as a result. The Board also desires to combine AGR and AGR-Lite over time into one insurance plan.

There are other areas where product simplification is proceeding. For example, the Board worked with RMA to develop a proposed rule combining the many existing APH and all individual revenue insurance plans for major crops into one consolidated plan of insurance. The producer will be able to choose a yield-based or revenue-based product from the options in the combined policy according to individual needs. This combined policy is expected to be available, in conjunction with development of a new software system, for the 2009 crop.

Lack of livestock insurance products has historically been a key gap in insurance coverage. ARPA authorized pilot programs to evaluate effectiveness of risk management tools for livestock producers with an annual spending limit of $20 million. The first livestock pilot was offered in 2003 for swine in Iowa. We now have Livestock Risk Protection (LRP), which covers hog, fed cattle, and feeder cattle prices, and Livestock Gross Margin (LGM), which has covers the margin between hog prices and feed costs and was extended to fed and feeder cattle in 2006. In the 2006 crop year, these programs insured around $190 million in livestock. Both programs had very low loss ratios.

During the past year, an evaluation report was completed on the livestock price plans of insurance. The report offers many recommendations to improve the attractiveness and effectiveness of these products, ranging from permitting higher coverage levels to eliminating the prohibition on offsetting trades to moving the sales window to earlier in the day to instituting a major agent training and producer educational effort. The Board authorized RMA to develop a plan to implement the recommendations were merited. On April 27, 2007, RMA announced a number of changes effective July 2007 for LRP and LGM, which should improve their effectiveness and marketability.

For the 2007 reinsurance year, the Board also approved an LRP pilot program for lamb. This product insures a lamb price. This new product was a new challenge for the Board. The product uses econometric modeling as the basis for establishing the insurance guarantee, the first such product for FCIC. Approval of this pilot came about only after exhaustive meetings and studies to evaluate using a model's projected price to determine an insurance guarantee for those commodities for which there are no established markets to permit price discovery. If the pilot proves successful, this method could be extended to other products for which an established commodity market does not exist.

In April 2007, the Board also approved for expert review two alternative milk revenue-type plans of insurance. If ultimately approved for sale, these would be the first milk insurance plans offered by FCIC.

In August 2006, RMA announced the availability of the Pasture, Rangeland, Forage insurance products for pasture and rangeland. Addressing the needs of livestock producers has been a top priority for the Board. There are over 400 million acres of rangeland, 120 million acres of pasture, and 62 million acres of hay in the United States. However, pasture, rangeland and forage situations are so diverse across the country, so existing insurance products were limited in their usefulness because they were based on an individual's forage production or on NASS estimates of hay production. The Board culminated a several year process of development by approving two pasture, range, and forage pilot programs that are being offered for sale for the first time for the 2007 crops. The new insurance products are area based products that trigger indemnities based on indexes. One index is based on accumulated rainfall and the other is based on a temperature-adjusted measure of vegetation obtained from the National Oceanographic and Atmospheric Administration. Both products will use new technology to help solve the problem of the inability to directly measure forage production across the diverse range and pasture settings on U.S. farms and ranches. Each pilot program is offered in six states.

The Board has spent much time trying to implement a premium discount for producers. The controversy over Premium Reduction Plans led the Board to investigate the possibility of providing an experience-based discount for producers. A final submission for an experience-based discount, developed under contract, was presented to the Board last fall. The proposal called for discounts based on a producer's loss ratio compared with the loss ratio of other producers in the county. The Board believed that this proposal would have led to many inequities and was not in the best interests of producers. For example, producers with high loss ratios operating in a high loss ratio county may receive discounts, while producers with lower loss ratios in lower loss ratio counties may not. Also, it would have been possible that producers with poorer yield experiences than other producers in a county to receive discounts because their loss ratios were lower, not due to a better yield experience, but because they purchased lower coverage levels. In early 2007 the Board voted not to approve this experience-based discount proposal after expert review and much analysis by the RMA and the Board.

One of the goals of producer discounts is to provide producers with premium costs that better reflect their individual risks. The Board closely follows RMA premium rate adjustments, and RMA has extensive efforts underway to improve ratings and risk classification. The improvement in the program's loss ratio over time partly reflects a continuing effort to implement more actuarially sound premium rates. In addition, during the past year, the Board approved a new method to determine unit discounts. RMA is also updating rating models and improving reference yields. Collectively, these most recent efforts will further improve risk classification and align premium rates more closely with an individual grower's risk of loss. As these adjustments are implemented, they will obviate the need for, and benefits of, more ad hoc adjustments such as the experience-based discount that the Board rejected.

The Board has an ongoing effort to address the effects of successive years of declining yields on producers' abilities to buy sufficient insurance coverage. When such yield losses occur, producers' coverage declines and premium rates increase. Two separate development contracts were completed and sent for expert review during early 2007. One contract developed an indexed yield approach for corn, cotton, soybeans, and wheat. Another contract developed alternatives to the current APH yield methods that limit the amount yields may drop. At its April 2007 meeting, the Board tabled both products and asked RMA to assess the feasibility of a hybrid approach using concepts from each of the contracted studies and report back to the Board.

Conclusion

Federal crop insurance has advanced much in recent years. It has not, as hoped, prevented calls for ad hoc disaster assistance, and it may not have generated the volume of new product submissions from the private sector envisioned at the inception of ARPA. But, we have seen steadily more effective risk management tools become available to producers and improvement in the actuarial performance of the program. As the 2007 farm bill comes into focus, one certainty will be the continuing need to improve and make available more cost-effective risk management tools such as crop insurance. The FCIC Board will continue to diligently examine, encourage, and demand improvements in insurance products that are in the interest of producers, that are actuarially appropriate, and that protect the interests of the American taxpayer. That completes my comments.

Item	**1998**	**2006 Estimated**
No. of policies (Mil.)	1.243	1.147
Insured liability (Bil. $)	27.9	49.9
Liability per policy ($)	22,469	43,490
Acres enrolled (Mil.)	181.8	242.1
Acres in CAT (Mil.)	61.5	28.5
Acres in buy-up (Mil.)	120.3	213.6
Loss ratio 1/	0.89	0.75
Producer loss ratio 2/	1.80	1.80
Indemnities paid (Bil. $)	1.678	3.415
Total premium (Bil. $)	1.876	4.577
Producer paid premiums (Bil. $)	0.930	1.897
Premium subsidies (Bil. $)	0.946	2.680

Premium subsidy rate for 55% coverage on an APH policy (%)	46.1	64
Premium per policy ($)	1,510	3,989
Administrative and operating expense reimbursement to AIPs (Bil. $)	0.443	0.958
Underwriting gains of AIPs (Bil. $)	0.280	0.890
Program cost (Bil. $) 3/	1.471	3.366

Table--Changes in Federal Crop Insurance Program Indicators, pre and post ARPA
ARPA=Agricultural Risk Protection Act of 2000
CAT= catastrophic coverage
AIP=approved insurance provider (reinsured companies)
1/ Indemnities divided by total premiums
2/ Indemnities divided by producer paid premiums
3/ Total indemnities minus producer paid premiums plus administrative and operating expense reimbursement plus underwriting gains of AIPs (excludes RMA salaries and expenses)